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IN THE

Supreme Court of the United States

October Term, 1941.

No. 656.

NORMAN JOHNSON, Suing on Behalf of Himself and All Other Stockholders in THE CURTIS PUBLISHING COMPANY, Similarly Situated Who, Being Interested in the Subject Matter of the Complaint, Shall Become Parties Hereto,

Petitioner,

against

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, and THE CURTIS PUBLISHING COMPANY,

Respondents.

PETITIONER'S REPLY BRIEF.

ARTHUR GARFIELD HAYS,
Solicitor for Petitioner.

International, 236 Chestnut St., Philadelphia

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IN THE

Supreme Court of the United States.

No. 656. October Term, 1941.

NORMAN JOHNSON, SUING ON BEHALF OF HIMSELF AND ALL OTHER STOCKHOLDERS IN THE CURTIS PUBLISHING COMPANY, SIMILARLY SITUATED WHO, BEING INTERESTED IN THE SUBJECT MATTER OF THE COMPLAINT, SHALL BECOME PARTIES HERETO,

Petitioner,

—against—

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, AND THE CURTIS PUBLISHING COMPANY,

Respondents.

PETITIONER'S REPLY BRIEF.

I.

The respondents' argument in chief is that the contract of the preferred stockholders as described in the corporate resolution dated December 16, 1925 (Respondents' Br., 3) permits an amendment to the preferred stock contract and the creation and issuance of new securities as in this case, *conditioned only upon the consent of the holders of two-thirds of the preferred stock outstanding.* If re-

spondents' thesis were correct, then any change whatsoever in the relation of a stockholder to the corporation and to the other stockholders could be effected merely upon a sufficient vote percentagewise. The argument is untenable for it fails to take into account:

(a) The restrictions upon the exercise of the reserved power which have been recognized by the law for many years.

(See cases cited in Petitioner's Main Brief, Point II.)

(b) The well-established lines of cases holding that regardless of the vote the amendment must be fair and equitable (Points III and IV of Petitioner's Main Brief).

Respondents misapprehend petitioner's argument as to the duty owed to the minority by stockholders in control of a corporation. Respondents argue that the majority did not impose upon the minority in this case because all of the preferred stockholders were offered the same exchange privileges. The point urged by petitioner, however, is that the dominant common stockholders who were in complete control of the corporation and the directors whom they elected sponsored the plan with the intent and for the purpose of benefiting themselves at the expense of preferred stockholders; respondents' own witnesses so admitted (Petition 6, Main Brief 26).

In *Southern Pacific Co. v. Bogert*, 250 U. S. 483, the majority stockholders overreached at the expense of the minority and the Court granted relief to the minority. The Court said at page 487:

> "The rule of corporation law and of equity invoked is well settled and has been often applied. The The majority has the right to control; but when it does

so, it occupies a fiduciary relation toward the minority, as much as the corporation itself or its officers and directors."

More recently, in *Pepper v. Litton,* 308 U. S. 295, the Court said at page 306:

> "* * * A director is a fiduciary. *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co. v. Bogert,* 250 U. S. 483, 492. Their powers are powers in trust. See *Jackson v. Ludeling,* 21 Wall. 616, 624. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. *Geddes v. Anaconda Copper Mining Co.,* 254 U. S. 590, 599. *The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside."* (Italics ours.)

(c) The contract provision of the preferred stock quoted in respondents' brief (p. 8) refers only to a charter amendment as to the creation of securities, not their issuance. Petitioner's contention that the new securities, including the debentures, were issued without valid consideration *benefiting the corporation* remains unanswered.

II.

Respondents are correct in stating that the common stockholders did not receive new common but merely retained their original shares but are in error when they state that these shareholders gave up "almost 50% in their com-

mon stock equity." Whatever equity had originally been applicable to the common stock had long since been wiped out. Therefore there was no equity for them to give up (Appellant's Appendix 85, 41).

III.

In attempting to distinguish the case of *Westchester and Philadelphia R. R. Co. v. Jackson*, 77 Pa. 321, respondents fall back on the curious assertion that the Court held the new consolidated preferred stock to be common stock, by whatever name called. Further study of that case fails to disclose any assertion or reasoning by the Court justifying such an analysis. On the contrary, the new stock had attributes which common stock does not have: it had a fixed dividend rate (8%); the dividend was cumulative; it held a preference over any other stock as to dividends.

The claim that in the *Westchester* case there was no reservation of a power to issue additional stock is likewise fallacious. The reserve power is inherent in the legislature limited only by the extent to which rights are "vested." To say that the reserve power to issue stock was not evidenced by the corporate charter in the *Westchester* case is merely begging the question.

The statute (contract) in the *Westchester* case authorized the issuance of the new preferred upon the affirmative vote of a majority of the stock. If the argument adopted by respondents in defense of their own reorganization were applied in the *Westchester* case, where an overwhelming majority vote was obtained, the dissenting preferred stockholder in that case would have had no redress. That case illustrates the absurd result to which respondents' thesis leads: since the exchange offer in that case was open to

common as well as preferred shareholders, the common became preferred over the dissenting original preferred

IV.

In asserting that this case presents no federal question, the respondents rely on *Kreicker v. Naylor Pipe Co.*, 374 Ill. 364, 29 N. E. (2d) 502, affd. 312 U. S. 659. It will be observed, however, that the *Kreicker* case was an appeal from a decision of the highest court of the State of Illinois construing a contract made by an Illinois corporation under the laws of that state. The cases cited by this Court in affirming that decision were all cases likewise involving appeals from the highest court of each state in the respective cases. The present case, however, does not come to this Court from a state court but from the United States Circuit Court of Appeals. The subject matter of this action lies directly in the jurisdiction of the United States Courts on the basis of diversity of citizenship between the parties; and the cases heretofore decided by the highest court of the Commonwealth of Pennsylvania and with which the decision of the Circuit Court appears to be in conflict are cited in the petition (8, 11).

V.

The cases upon which respondents rely in support of their general position (Resp. Brief 8) all differ from the present case upon the facts therein involved. The following are among the distinguishing features of these cases:

(a) In the present case the respondents' witnesses testified that no reorganization was necessary because of the company's financial condition, which was excellent, and that the plan was motivated instead by the common stockhold-

ers' financial position in relation to the company (Main Brief 26). In each of the cases cited by respondents, the corporation itself was expressly found by the Court to be in serious financial difficulties. In fact, in *Johnson v. Lamprecht,* 133 Ohio St. 567, 15 N. E. (2d) 127, the Court said:

> "If there is a surplus the action usually has been enjoined."

In the present case, the respondent corporation had a fund designated "Contingent Reserve (earned) and Undivided Profits" amounting to $20,251,304.61 available for payment of dividends (Petition 5; Appellant's Appendix 41).

(b) In the present case through the medium of debentures a large portion of "surplus" was made available to assenting preferred stockholders but withheld from non-assenting shareholders of the same class. This did not occur in any of the cases cited except in *Ainsworth v. South Western Drug Corp.,* 95 Fed. (2d) 172, where the accumulated dividends were paid to assentors *in full* by the issuance of income dividend notes.

(c) In the present case, the evidence showed that the corporation through purchases of its own stock and the issuance of debentures created charges to "surplus" substantially equal to the full amount of the accumulated dividends on all of the outstanding shares of preferred stock. This was not true in the cited cases except to an extent in the *Ainsworth* case as pointed out above.

(d) In the present case, petitioner contends that the right of parity among the preferred stockholders was violated. The question of parity was not considered by the Court in any of the cases cited by respondents.

Citation of these cases by respondents in no way alters the fact that conflicts and uncertainties in the law exist as shown in petitioner's petition. For example, if the cases on which respondents rely are to be construed as they construe them, then the case of *Buckley v. Cuban American Sugar Co.* (New Jersey Chancery Court, New Jersey Law Journal, August 22, 1940), is directly contrary. There the sugar company had 7% Preferred Stock ($100 per share) and Common Stock outstanding. Accumulated dividends on the Preferred Stock amounted to $54.50 per share. The company offered to exchange for each share of Preferred:

1 4/10 shares of 5½% Convertible Preferred Stock (par value $100 per share);

$14.50 in cash.

The company had an earned surplus of $16,000,000. The plan was enjoined.

In fact, the New Jersey cases as a whole appear contrary. (*General Investment Co. v. American H. & L. Co.*, 98 N. J. Eq. 326, 129 Atl. 244).

Conflict also exists between the present case and certain statements in *Yoakam v. Providence Biltmore Hotel Co.*, 34 Fed. (2d) 533. In the *Yoakam* case, the Court declared (542) that any reclassification which permits surplus existing at the time the plan is consummated to be used for payments to newly created senior securities would be invalid. In the present case as it stands, there is nothing to protect the $20,000,000 Contingent Reserve (earned) and Undivided Profits against invasion by the stockholders assenting to the plan. Not only may they receive dividends from this fund, but if the corporation were liquidated today, the assentors would receive the entire fund to the exclusion of the non-assentors.

The unsatisfactory and unsettled state of the law is indicated by the recent articles and notes appearing in the law reviews. For example, see *Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine* by John F. Meck, Jr., Harvard Law Review, Vol. LV, No. 1, p. 71, November, 1941.

The within case affords the opportunity of settling this important problem authoritatively.

Respectfully submitted,

ARTHUR GARFIELD HAYS,
Solicitor for Petitioner.